

Community Health Centers of Southern Iowa, Inc.

Accountants' Report and Financial Statements

November 30, 2009 and 2008

Independent Accountants' Report

Board of Directors
Community Health Centers
of Southern Iowa, Inc.
Leon, Iowa

We have audited the accompanying balance sheets of Community Health Centers of Southern Iowa, Inc. (the "Organization") as of November 30, 2009 and 2008, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Health Centers of Southern Iowa, Inc. as of November 30, 2009 and 2008, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

August 16, 2010

Community Health Centers of Southern Iowa, Inc.

Balance Sheets

November 30, 2009 and 2008

Assets

	2009	2008
Current Assets		
Cash	\$ 73,341	\$ 15,817
Certificates of deposit	14,424	14,324
Patient accounts receivable, net of allowance; 2009 - \$550,000, 2008 - \$582,356	456,417	584,336
Grants and other receivables	85,729	45,579
Pharmacy inventory	80,343	71,724
Estimated amounts due from third-party payers	150,000	150,000
Prepaid expenses and other	12,084	17,135
Total current assets	<u>872,338</u>	<u>898,915</u>
Property and Equipment, At Cost		
Land and land improvements	14,000	14,000
Buildings and leasehold improvements	536,564	517,674
Equipment	454,718	372,617
Construction in progress	74,500	-
	<u>1,079,782</u>	<u>904,291</u>
Less accumulated depreciation	<u>366,526</u>	<u>285,029</u>
	<u>713,256</u>	<u>619,262</u>
Total assets	<u>\$ 1,585,594</u>	<u>\$ 1,518,177</u>

Liabilities and Net Assets

Current Liabilities		
Line of credit	\$ 40,010	\$ 186,181
Current maturities of long-term debt	79,842	26,037
Accounts payable	85,364	99,509
Accrued expenses	157,912	191,778
Due to Decatur Medical Services	-	191,992
Deferred grant revenue	-	9,204
Total current liabilities	<u>363,128</u>	<u>704,701</u>
Long-Term Debt	<u>298,399</u>	<u>178,241</u>
Total liabilities	<u>661,527</u>	<u>882,942</u>
Net Assets		
Unrestricted	875,916	587,132
Temporarily restricted	48,151	48,103
Total net assets	<u>924,067</u>	<u>635,235</u>
Total liabilities and net assets	<u>\$ 1,585,594</u>	<u>\$ 1,518,177</u>

Community Health Centers of Southern Iowa, Inc.

Statements of Operations

Years Ended November 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Unrestricted Revenues, Gains and Other Support		
Net patient service revenue	\$ 3,678,752	\$ 2,300,633
Grant revenue	1,220,059	887,834
Contributions	134,352	71,282
Other	<u>20,820</u>	<u>41,766</u>
Total unrestricted revenues, gains and other support	<u>5,053,983</u>	<u>3,301,515</u>
Expenses and Losses		
Salaries and wages	2,725,051	1,909,619
Employee benefits	542,773	349,987
Purchased services and professional fees	173,691	240,507
Supplies and other	1,119,845	539,766
Rent	94,812	69,237
Depreciation	81,497	71,311
Interest	22,517	29,002
Provision for uncollectible accounts	<u>107,557</u>	<u>232,805</u>
Total expenses and losses	<u>4,867,743</u>	<u>3,442,234</u>
Operating Income (Loss)	186,240	(140,719)
Other Income		
Investment return	<u>324</u>	<u>2,251</u>
Excess (Deficiency) of Revenues Over Expenses	186,564	(138,468)
Grants for the acquisition of property and equipment	<u>102,220</u>	<u>56,265</u>
Increase (Decrease) in Unrestricted Net Assets	<u><u>\$ 288,784</u></u>	<u><u>\$ (82,203)</u></u>

Community Health Centers of Southern Iowa, Inc.

Statements of Changes in Net Assets Years Ended November 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Unrestricted Net Assets		
Excess (deficiency) of revenues over expenses	\$ 186,564	\$ (138,468)
Grants for the acquisition of property and equipment	<u>102,220</u>	<u>56,265</u>
Increase (decrease) in unrestricted net assets	<u>288,784</u>	<u>(82,203)</u>
Temporarily Restricted Net Assets		
Contributions	<u>48</u>	<u>8,218</u>
Increase in temporarily restricted net assets	<u>48</u>	<u>8,218</u>
Change in Net Assets	288,832	(73,985)
Net Assets, Beginning of Year	<u>635,235</u>	<u>709,220</u>
Net Assets, End of Year	<u><u>\$ 924,067</u></u>	<u><u>\$ 635,235</u></u>

Community Health Centers of Southern Iowa, Inc.

Statements of Cash Flows

Years Ended November 30, 2009 and 2008

	2009	2008
Operating Activities		
Change in net assets	\$ 288,832	\$ (73,985)
Items not requiring (providing) cash		
Depreciation	81,497	71,311
Change in contributed inventory	(48)	(8,218)
Grants for acquisition of property and equipment	(102,220)	(56,265)
Changes in		
Patient accounts receivable, net	127,919	(177,386)
Grants receivable	(40,150)	10,868
Estimated amounts due from third-party payers	-	(75,000)
Inventory	(8,571)	(17,141)
Accounts payable and accrued expenses	(240,003)	216,379
Other current assets and liabilities	(4,153)	10,497
Net cash provided by (used in) operating activities	103,103	(98,940)
Investing Activities		
Acquisition of certificates of deposit	(100)	(453)
Purchase of property and equipment	(175,491)	(59,238)
Net cash used in investing activities	(175,591)	(59,691)
Financing Activities		
Proceeds from line of credit	1,958,501	1,380,746
Principal payments on line of credit	(2,104,672)	(1,394,802)
Proceeds from grant for acquisition of property and equipment	102,220	153,730
Proceeds from issuance of long-term debt	200,000	-
Principal payments on long-term debt	(26,037)	(7,933)
Net cash provided by financing activities	130,012	131,741
Increase (Decrease) in Cash	57,524	(26,890)
Cash, Beginning of Year	15,817	42,707
Cash, End of Year	\$ 73,341	\$ 15,817
Supplemental Cash Flows Information		
Interest paid	\$ 22,517	\$ 29,002
Inventory acquired through noncash contributions	\$ 86,400	\$ 51,500

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

November 30, 2009 and 2008

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Community Health Centers of Southern Iowa, Inc. (the "Organization") is a federally qualified health center that works to improve, promote and maintain the physical and emotional health of people in the communities it serves. The Organization primarily earns revenues by providing physician and related health care services through clinics located in Decatur County, Iowa, serving an eight county service area in Iowa and Missouri.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Investment Return

Investment return is comprised of interest income.

Patient Accounts Receivable

The Organization reports patient accounts receivable for services rendered at estimated net realizable amounts from third-party payers, patients and others. The Organization provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Organization bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Pharmacy Inventory

The Organization states pharmacy inventories at the lower of cost, determined using the first-in, first-out method, or market.

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

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Property and Equipment

Property and equipment are depreciated on a straight-line basis over the estimated useful life of each asset. Leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Certain property and equipment have been purchased with grant funds received from the U.S. Department of Health and Human Services. Such items may be reclaimed if not used to further the grant's objectives.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Organization has been limited by donors to a specific time period or purpose.

Net Patient Service Revenue

The Organization has agreements with third-party payers that provide for payments to the Organization at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

November 30, 2009 and 2008

Government Grant Revenue

Support funded by grants is recognized as the Organization performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by granting agencies and, as a result of such audits, adjustments could be required.

In-Kind Revenue

The Organization recognizes donated pharmaceutical supplies at fair value. Donated pharmaceutical supplies totaling \$86,352 and \$50,500 are recorded as contribution revenue and supplies and other expense for the years ended November 30, 2009 and 2008, respectively. The Organization also recognized in-kind rent revenue and expense totaling \$48,000 and \$31,600 for the years ended November 30, 2009 and 2008, respectively.

Income Taxes

The Organization has been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Organization is subject to federal income tax on any unrelated business taxable income.

Excess (Deficiency) of Revenues Over Expenses

The statements of operations include excess (deficiency) of revenues over expenses. Changes in unrestricted net assets which are excluded from excess (deficiency) of revenues over expenses, consistent with industry practice, include contributions and grants of long-lived assets (including assets acquired using contributions or grants which by donor or granting agency restriction were to be used for the purpose of acquiring such assets).

Subsequent Events

Subsequent events have been evaluated through August 16, 2010, which is the date the financial statements were available to be issued.

Note 2: Grant Revenue

The Organization is the recipient of a Consolidated Health Centers (CHC) grant from the U.S. Department of Health and Human Services (the "granting agency"). The general purpose of the grant is to provide expanded health care service delivery for residents of the eight county service area in Iowa and Missouri. Terms of the grant generally provide for funding of the Organization's operations based on an approved budget. Grant revenue is recognized as qualifying expenditures

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Notes to Financial Statements

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are incurred over the grant period. During the years ended November 30, 2009 and 2008, the Organization recognized \$675,951 and \$650,916 in CHC grant revenue, respectively. The Organization is approved for funding in the amount of \$675,951 for the year ending November 30, 2010.

In response to the current economic conditions, the federal government passed legislation appropriating grant dollars to community health centers under the American Recovery and Reinvestment Act (ARRA). The Organization has been awarded \$148,990 under the Increased Demand for Services (IDS) grant for the period of March 27, 2009, to March 26, 2011, to assist in meeting the needs of the communities served and \$448,380 under the Capital Improvement Program (CIP) grant for the period of June 29, 2009, to June 28, 2011, for equipment. Grant revenue is recognized as qualifying expenditures are incurred over the grant periods. During the years ended November 30, 2009, and 2008, the Organization recognized \$15,788 and \$0 in IDS grant revenue, respectively. As of November 30, 2009, the Organization had not expended any CIP grant revenue.

In addition to these grants, the Organization receives additional financial support from other federal, state and private sources. Generally, such support required compliance with terms and conditions specified in the grant agreements and must be renewed on an annual basis.

Note 3: Net Patient Service Revenue

The Organization is approved as a FQHC for both Medicare and Medicaid reimbursement purposes. The Organization has agreements with third-party payers that provide for payments to the Organization at amounts different from its established rates. These payment arrangements include:

Medicare. Covered FQHC services rendered to Medicare program beneficiaries are paid based on a cost reimbursement methodology. The Organization is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of an annual cost report by the Organization and audit thereof by the Medicare fiscal intermediary. Services not covered under the FQHC benefit are paid based on established fee schedules.

Medicaid. Covered FQHC services rendered to Medicaid program beneficiaries are paid based on a cost reimbursement methodology. The Organization is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of an annual cost report by the Organization and audit thereof by the Medicaid fiscal intermediary.

Approximately 52% and 65% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended November 30, 2009 and 2008, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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The Organization has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Organization under these agreements includes prospectively determined rates per unit of service and discounts from established charges.

Note 4: Concentration of Credit Risk

The Organization grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at November 30, 2009 and 2008, is:

	2009	2008
Medicare	16%	35%
Medicaid	27%	30%
Other third-party payers and patients	57%	35%
	100%	100%

Note 5: Medical Malpractice Claims

The U.S. Department of Health and Human Services deemed the Organization and its practicing providers covered under the Federal Tort Claims Act (FTCA) for damage for personal injury, including death resulting from the performance of medical, surgical, dental and related functions. FTCA coverage is comparable to an occurrence policy without a monetary cap. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Organization's claim experience, no such accrual has been made. However, because of the risk in providing health care services, it is possible that an event has occurred which will be the basis of a future material claim.

Note 6: Line of Credit

At November 30, 2009, the Organization had a \$200,000 bank line of credit bearing interest at the bank's prime rate plus 1.50% with a minimum rate of 6.5% (currently 6.5%), due on April 29, 2010. At November 30, 2009, the outstanding principal balance on the line of credit was \$40,010.

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

November 30, 2009 and 2008

At November 30, 2008, the Organization had a \$400,000 bank line of credit bearing interest at 8.250%, due November 30, 2008. At November 30, 2008, the outstanding principal balance on the line of credit was \$386,181. Subsequent to November 30, 2008, this line of credit was restructured into two separate financing arrangements. \$200,000 of the line of credit's balance was refinanced into a note payable (see *Note 7*) and the remaining principal balance was included in the line of credit that expires on April 29, 2010.

Note 7: Long-Term Debt

	2009	2008
Note payable, bank (A)	\$ -	\$ 4,278
Note payable, bank (B)	200,000	-
Note payable, bank (C)	178,241	200,000
	<u>378,241</u>	<u>204,278</u>
Less current maturities	<u>79,842</u>	<u>26,037</u>
	<u>\$ 298,399</u>	<u>\$ 178,241</u>

- (A) Promissory note to Clarke Electric Coop. Due June 14, 2009; payable \$611 monthly; bearing 0% interest; secured by the Organization's real estate.
- (B) Promissory note to Decatur Medical Services, due July 1, 2015; payable in six annual payments of \$33,333 plus accrued interest thereon, the first of which is due July 1, 2010; bearing interest at a rate equal to the United States prime rate as listed in the Eastern print edition of the Wall Street Journal on the first business day following June 30 of each year, less 1% (currently 2.25%); unsecured.
- (C) Promissory note to Great Western Bank, due May 2013; principal of \$200,000 payable by monthly payments of \$4,805 bearing 7% interest, secured by commercial property at 802 East Ackerly.

Aggregate annual maturities of long-term debt at November 30, 2009, are:

2010	\$ 79,842
2011	83,253
2012	86,899
2013	61,579
2014	<u>66,668</u>
	<u>\$ 378,241</u>

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

November 30, 2009 and 2008

Note 8: Functional Expenses

The Organization provides health care services primarily to residents within its service area. Expenses related to providing these services are as follows:

	2009	2008
Health care services	\$ 3,310,668	\$ 2,197,060
General and administrative	1,557,075	1,245,174
	<u>\$ 4,867,743</u>	<u>\$ 3,442,234</u>

Note 9: Operating Leases

The Organization leases various facilities under operating leases expiring at various dates through 2011 with options to renew through 2020.

Future minimum lease payments at November 30, 2009, were:

2010	\$ 8,928
2011	<u>6,900</u>
Future minimum lease payments	<u>\$ 15,828</u>

Note 10: Pension Plan

The Organization has a defined contribution pension plan covering substantially all employees. The Organization contributes up to 3% of eligible employees' compensation to the plan. Pension expense was \$67,407 and \$35,681 for the years ended November 30, 2009 and 2008, respectively.

Note 11: Construction in Progress

The Organization is in the process of implementing a new electronic medical records system. The implementation of this system has an estimated cost of approximately \$200,000 and is expected to be completed in October 2010. This project will be financed through federal grant monies, operating funds, and the Organization's line of credit, as needed. As of November 30, 2009, the Organization has incurred \$74,500 of costs related to this project's planning and implementation.

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

November 30, 2009 and 2008

Note 12: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in *Notes 1* and *3*.

Grant Awards

A concentration of revenues related to grant awards is described in *Note 2*.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in *Note 5*.

Practicing Providers

The Organization is served by three providers whose patients comprise a substantial portion of the Organization's net patient service revenue.

Human Resources Services and Administration Site Visit

In an onsite visit and report dated April 22, 2009, by the Health Resources Services and Administration (HRSA), certain concerns were raised. These concerns were predominantly due to the absence of a formal agreement related to the acquisition of Decatur Medical Services. While the Organization feels that they have taken the necessary steps to address the concerns, the effect of any noncompliance on future grant funding is not known and could have a material effect on the financial statements in the future.

Current Economic Conditions

The current protracted economic decline continues to present community health centers with circumstances and challenges, which in some cases have resulted in declines in the fair value of assets and potential future declines in contributions. The financial statements have been prepared using values and information currently available to the Organization.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Organization's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Community Health Centers of Southern Iowa, Inc.

Notes to Financial Statements

November 30, 2009 and 2008

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change in the future, resulting in future adjustments in allowances for accounts receivable that could negatively impact the Organization.